
IOWA UTILITIES BOARD Energy Section

Docket No.: RPU-2013-0002
Utility: Iowa-American Water Company
Memo Date: April 3, 2014

TO: The Board

FROM: Barb Oswalt

SUBJECT: Recommendation to Reject Proposed Compliance Tariffs

I. Background and Analysis

In its final order, the Board ordered Iowa-American Water Company (Iowa-American) to file compliance tariffs that recover all public fire costs and 25 percent of private fire costs through the general metered services rates—half through the fixed monthly charge and half through volumetric rates. On March 6, 2014, Iowa-American filed its proposed compliance rates in Docket No. RPU-2013-0002. Staff had concerns with the proposed compliance rates and General Counsel arranged a conference call so that staff could voice those concerns to Iowa-American and the Office of Consumer Advocate (Consumer Advocate). On March 11, 2014, Iowa-American filed additional information staff had requested following the conference call; however, this information did not fully address staff's concerns. On March 12, 2014, General Counsel sent an e-mail to the parties with a detailed description of additional information required for staff's review. On March 18, 2014, Iowa-American filed additional information in response to the e-mail request. Also on March 18, 2014, the Consumer Advocate filed a conditional objection to Iowa-American's compliance filing and also requested it be given ten days to respond to Iowa-American's filings. On March 27, 2014, Consumer Advocate filed an objection to Iowa-American's compliance rates. On March 31, 2014, Iowa-American responded to Consumer Advocate's objection.

II. Legal Standards

The Board has jurisdiction of the parties and subject matter in Docket No. RPU-2013-0002, pursuant to Iowa Code chapter 476 (2013).

III. Analysis

Iowa-American

Iowa-American proposes to recover the applicable fire-related costs through the customer charges based on number of customers instead of meter equivalents which is the approach Iowa-American used when the case was initially filed. The meter equivalents approach allocated costs based on the relative size of the customer. The

Board's decision in this case requires that 50 percent of the public fire costs and 12.5 percent of private fire costs are recovered through the customer charges and the remaining 50 percent of public fire costs and 12.5 percent of private fire costs are recovered through the volumetric rates. Iowa-American argues that by allocating half of the recoverable costs to the volumetric charge, the Board is effectively charging the larger customers more as these larger customers will typically consume more water. Iowa-American argues the balance of the costs should be allocated based on the number of bills as more costs have already been allocated to the larger customers through the volumetric rates. Recovering these costs based on meter equivalents would effectively charge the larger customers twice based on their size. For example, a Commercial Customer with a 2-inch meter will be paying 8 times the fire contribution to the customer charge due to customer charges being based on meter equivalents. The table below shows two sets of monthly customer charges (one set based on the number of customers, which is the approach Iowa-American supports in its compliance filing, and the other based on meter equivalents) along with the proposed volumetric rates.

<u>Monthly Customer Charges</u>			<u>Volumetric Rates</u>	
	Based On No. of Customers	Base On Meter Equivalents	Dollars per CCF	
5/8"	\$14.08	\$13.36	Block 1	\$3.8562
3/4"	\$21.11	\$20.03	Block 2	\$2.6266
1"	\$35.19	\$33.39	Block 3	\$2.1512
1 1/2"	\$70.39	\$66.77	Block 4	\$1.6558
2"	\$112.62	\$106.83		
3"	\$211.14	\$200.29		
4"	\$351.90	\$333.82		
6"	\$703.83	\$667.66		
8"	\$1,126.10	\$1,068.24		
10"	\$1,618.85	\$1,535.67		

Consumer Advocate

On March 28, 2014, the Consumer Advocate filed an objection to Iowa-American's compliance filing. Consumer Advocate states that Iowa-American's proposed compliance tariffs disproportionately affect residential customers based on how fire-related costs are being recovered. Consumer Advocate requests that the Board direct Iowa-American to spread the rate increase (including fire protection costs allocated to volumetric rates) evenly across all usage, and to calculate the monthly customer charge based on meter equivalents which results in a rate of \$13.36¹ for a 5/8-inch meter.

Iowa-American Reply

Iowa-American argues that its proposed volumetric and customer charges are consistent with Iowa-American's compliance cost-of-service study. The Consumer

¹ The rates for the other meter sizes are scaled based on the 5/8-inch meter charge.

Advocate's proposal would result in the allocation of a disproportionate and unreasonable amount of costs to the large water customers. Customers generally benefit from public fire service commensurate with the size of their property. Prior to the Board's decision on this issue, cost recovery of 100 percent of public fire costs was based on meter equivalents which recovered costs based on the relative size of the customer's premises.

Customer Charge. Iowa-American argues that recovering 50 percent of the applicable fire-related costs through the volumetric charge effectively results in charging larger customers more, as these larger customers will typically consume more water. For this reason, Iowa-American believes the portion of applicable fire-related costs recovered through the customer charge should be based on the number of customers rather than on meter equivalents. Customer charges based on meter equivalents produce lower customer charges which shifts more cost recovery to the volumetric rates. It is more equitable (and consistent with the AWWA rate manual) to calculate monthly customer charges based on the number of customers.

Volumetric Rates. Once the appropriate customer charge is calculated, the remaining fire-related costs must be recovered from the volumetric rates. The Consumer Advocate correctly notes that the proposed compliance tariffs place more cost recovery on the first block of volumetric rates than the second block. Iowa-American stated that the change in the relative percentage increases in the first and second blocks is due to the change in the compliance class cost-of-service study based on the Board's determination on various revenue requirement, rate design, and cost-of-service issues. Since 97 percent of the residential class consumption is in the first block, the first block should receive a larger increase than the other blocks. Since Iowa-American's initial cost-of-service study did not allocate any fire costs to the volumetric rates, it is disingenuous of Consumer Advocate to claim Iowa-American is using a different methodology when it is merely making adjustments to its cost-of-service study in compliance with the Board's directive.

Staff Analysis

Staff has concerns with the methodology Iowa-American used to recover applicable fire-related costs in both general metered service rate elements (fixed and variable). The fire-related costs at issue here include 100 percent of the public fire costs and 25 percent of the private fire costs. In order to provide perspective regarding the impact of this change in cost allocation, it is worth noting that the addition of 25 percent of the allocated private fire costs has increased the amount of fire-related costs to be recovered from all customers from \$4,771,272 (public only) to \$5,947,954 (public and private). Private fire costs account for 20 percent of total fire-related costs to be recovered from all customers.

Customer Charge. According to staff's calculations based on test year billing units, Iowa-American's proposed compliance customer charges (based on number of customers) would result in the recovery of \$3,216,745 whereas customer charges

based on meter equivalents would recover \$2,535,889. Since half of the fire-related costs to be recovered from all customers is \$2,532,722, it is clear that rates based on meter equivalents more closely achieves the Board's directive to recover half of the costs through the customer charge. Staff recommends that the Board direct Iowa-American to file compliance rates that recover the applicable fire-related costs through the monthly customer charge based on meter equivalents as shown in Iowa-American's Attachment 1 – Alternative filed on March 18, 2014.

Volumetric Rates. Iowa-American's compliance tariff proposal for volumetric rates recovers all applicable fire-related costs from the first two of its four rate blocks. Staff believes that some portion of the applicable fire-related costs should be recovered from each unit of water sold. Limiting recovery to the first two rate blocks essentially converts a volumetric or variable rate to more of a fixed rate.

In Docket No. RPU-90-10,² Iowa-American proposed to recover all public fire costs through a uniform adjustment to all volumetric block rates. Iowa-American contended that the volumetric method best matched fire exposure risks to fire protection costs, since there is somewhat of a relationship between water use and the amount of property exposed to fire. The Board agreed with Iowa-American and directed Iowa-American to allocate those costs based on the base cost allocation factor in its cost-of-service study because it was the factor that most consistently measured general usage.

Staff believes that the portion recovered through volumetric rates should ultimately be recovered equally from each unit of water. However, based on the cost-of-service study in this case the result would be a significant reallocation of costs between classes. Costs would decrease for the residential class and increase for the remaining classes with the industrial class experiencing the largest increase. It appears that this would result in an overall increase for the industrial class that exceeds the increase Iowa-American originally requested applicable to the industrial class. Therefore, staff believes that the issue of uniform, per-unit recovery of the applicable fire-related costs should be addressed in a future rate proceeding.

Because Iowa-American's volumetric rates are applicable to all customer classes, it can be challenging to design rates that recover the appropriate costs for each customer class from the one set of rates. However, staff believes it is possible to design a rate structure that derives some portion of the applicable fire-related costs from each rate block in this case. The usage for the industrial class comprises almost 80 percent of the usage in blocks 3 and 4. Therefore, staff believes it would be reasonable to increase rate blocks 3 and 4 by, at a minimum, \$.0314³ which is a per-unit rate based on the total applicable fire-related costs and billing units for the industrial class.

This approach effectively guarantees that each unit of water will recover a portion of the applicable fire-related costs and moves Iowa-American's rates in the direction of uniform

² Iowa-American Water Company, Docket No. RPU-90-10, "Final Decision and Order," p. 68, 10/21/91.

³ Calculated based on half of the fire-related costs assigned to the industrial class (\$36,471) divided by total billing units for the industrial class (1,161,550).

per-unit recovery. The Board could then address this issue in greater detail in a future rate case.

Iowa-American water will need to make changes to the volumetric rates to reflect the lower monthly customer charges, and the recovery of fire-related costs from all rate blocks.

Private Fire Rates

Iowa-American's compliance filing also includes proposed private fire service rates. Staff believes these rates appear to be in compliance.

IV. Recommendation

Attached for the Board's consideration is an order rejecting the compliance tariffs Iowa-American filed on March 6, 2014, and directing Iowa-American to:

- a. File a compliance tariff with monthly customer charges calculated with the applicable fire-related costs based on meter equivalents;
- b. File revised volumetric compliance rates that, at a minimum, increase rate blocks 3 and 4 by \$0.0314 per CCF over the rates approved in Docket No. RPU-2011-0001, and that maintain the rate differential between rate blocks 1 and 2 to the maximum extent possible; and
- c. File revised proof-of-revenue calculations based on the new rates.

/blo